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SENSITIVE

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SUBJECT: TRANSITION #8: DOMINICAN CONGRESS AWASH WITH TAX  
CHANGE PROPOSALS

[1](#)1. (SBU) This is number 8 in our series covering the  
transition between the Mejia and the Fernandez governments.

DOMINICAN CONGRESS AWASH WITH TAX CHANGE PROPOSALS

Fifteen days ago President Mejia sent Congress the  
PLD-drafted fiscal package. The Fernandez team projected its  
proposal would increase revenues by 2.7 percent of GDP  
annually. The central measure is an increase in the  
value-added tax (ITBIS) from 12 to 16 percent. President  
Mejia has convoked an extraordinary session of Congress in  
order to give more time for the fiscal package, which may be  
passed before August 16 when Leonel Fernandez takes power.  
Members of Congress are actively debating the package with no  
one attempting to block it. It appears that Mejia and the  
PRD will not actively pursue a salary adjustment via  
legislative action. The consensus opinion is that the package  
is essential to getting the IMF back to the negotiating  
table.

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The Tax Work Continues  
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The Finance Committee of the Dominican House of  
Representatives continues its hearings, both private and  
public, on the tax package drafted by Leonel Fernandez's  
transition team and delivered by President Mejia "without one  
comma changed." (Mejia joked to Treasury Under Secretary John  
Taylor on July 10 that he would be "holding it out with a  
pair of pincers.") Congressional and business leaders are  
not in agreement on the shape the fiscal package will take.  
On July 23 the lower house held a hearing on the fiscal  
package with technical advisors from the PRSC,  
representatives of the Entrepreneurs' Council (CONEP), the  
National Association of Young Businessmen (ANJE) the National  
Association of Banks, the Association of Industrialists, the  
Association of Private Businesses, and the Hotel, Bar and  
Restaurant Association. On the PLD delivered proposed  
amendments negotiated with bankers and the private sector.  
PLD fiscal team leader Rafael Camilo indicated that as long  
as the revenue yield is unchanged, they will consider changes  
in broadening the base for the VAT, modifying taxes on rents,  
changing the mechanism for taxes on financial instruments and  
altering the structure of incentives for investment in the  
regions along the border with Haiti. Finance Committee  
chairman Marino Collante (PRSC) had earlier commented to the  
press that the fiscal package would certainly be amended  
before passage.

Congress busily cleaned up its agenda before the end of the  
regular session on July 27, passing legislation on public  
access to government information, national parks, nepotism in  
government, migration, sales of government owned land, and  
pension rights for Mejia administration employees. On July 22  
it ratified the Article 98 bilateral agreement with the  
United States on the International Criminal Court. Given the  
evident need for ample consultations and hearings on the tax  
measures, Mejia convoked the legislature into a special  
session that could last up to August 15, the day before the  
presidential inauguration.

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Content  
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The PLD's package focuses less on "reform" than on increasing  
revenues from taxes on consumption. It does little to alter  
the tax structure of the economy. Projections of revenue  
gained from taxes on a full-year basis indicate that it will  
not be sufficient to cover the fiscal deficit in the  
government budget, let alone to make a dent in the  
quasi-fiscal deficit of the Central Bank. The tax package  
focuses on taxes that are easily collected, generally those  
that have a pre-existing mechanism of enforcement. The  
value-added tax (VAT or ITBIS) would go from 12 percent to 16

percent, but the base would not be expanded (the Dominican Republic has one of the narrowest bases in the region, collecting ITBIS on only about 60 percent of sales). Tax increases likely to be passed along to the consumer will be those on financial services, alcoholic beverages, tobacco products, insurance, airline tickets, telecommunications, personal income, advertising, and rents.

Proposed measures facing strong opposition include the expansion of the 1 percent tax on real estate generally (both personal and business property), not just on high-value residences and commercial property (IVSS) valued over RD\$ 3 million or about US\$65,000. Even if passed in some form, these measures would be hampered by an insufficient tax infrastructure and database for collection. Taxes on rents may be unenforceable. After consultations between the PLD and the Commercial Bank Association the PLD delivered proposed amendments that would replace the proposed 15 percent tax on interest paid on financial instruments with a tax on check clearing, equivalent to 0.15% of the amount transferred (this will apply to credit card transactions and ATM operations, as well). The PLD gave in to the bankers and agreed to eliminate the proposed mandatory reporting of bank transfers to the tax collection authorities, a measure that bankers characterized as a violation of bank secrecy laws.

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Others with the Big Picture  
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At least three local economists or consulting institutions have proposed tax overhaul plans that focus on restructuring the tax code, but their efforts will have little impact on the current fiscal package. The PRD's economic consultant Andy Dauhajre, Jr., elaborated a tax reform proposal intended to collect taxes principally from the well off, but the PRD decision to give carte blanche to the incoming PLD team made this a dead letter. On the expenditure side of the debate, Grupo Leon, a power in beer, tobacco and banking, ran double-page ads all major papers describing a proposed program including reductions in government salaries and other state expenditures, continued reform of the banking and energy sectors, a tax amnesty applicable to repatriated capital and a 20 percent increase in salaries beginning in August. Grupo Leon advocates an increase in ITBIS to 16 now with commitment to a gradual reduction to a broader 10 percent ITBIS by 2007. Much current newspaper commentary focuses on the probable incidence of taxes, maintaining that most will be paid by the poor and the middle classes.

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Support for the Effort  
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Prominent members of government and the business community are putting their support behind the fiscal package, acknowledging that some kind of package, however imperfect, will be necessary to move toward financial stability and to bring the IMF back to the negotiating table. President of the lower house Alfredo Pacheco (PRD) has made public statements generally in support of the PLD fiscal package and the use of the ITBIS as its main revenue source. Business leader Elena Viyella de Paliza, the president of CONEP (the Entrepreneurs' Council), has asked for a consensus on accepting the tax reform.

President Mejia has continued to needle the PLD about a need for an early salary increase for public servants, but it appears that he and his party are less likely to pursue this point through legislative action. Mejia said nothing about salary increases when he had breakfast with Treasury Under Secretary Taylor on July.

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Comment  
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Embassy Santo Domingo expects that the fiscal package may be passed before the August 16 inauguration with only minor changes and with the support of government and industry leaders. The fiscal plan is only a first step and is so far confined to the revenue side of the budget. The new government will need an additional assortment of firm corrective measures in hand when it seeks to renew talks with the IMF. A major question is the approach that Fernandez and his team will take to government expenditure. The plan does not address persistent problems associated with subsidies for cooking gas or electricity, nor does it contain any commitments concerning the number of public employees or the wages to be paid to them. PLD commentators to date have stressed a "smaller but better paid public workforce." The rush for jobs by PLD supporters will make that difficult to achieve.

12. (U) Drafted by Mark Kendrick.

13. (U) This messages and others in our transition and elections series are available on the SIPRNET at <http://www.state.sgov.gov/p/wha/santodomingo/> along with extensive other material.  
HERTELL